

TOY MANUFACTURERS OF AMERICA



FINANCIAL AND OPERATING RATIO REPORT

1981

prepared by Touche Ross & Co.

October 18, 1982

TOY MANUFACTURERS OF AMERICA
FINANCIAL AND OPERATING RATIO REPORT
(ANNUAL BUSINESS SURVEY)

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**TO: Members Participating in the Toy Manufacturers of America
1981 Financial and Operating Ratio Report**

Gentlemen:

Your 1981 Financial and Operating Ratio Report has been organized to provide you with pertinent toy industry financial data. To facilitate a comparison of your current figures with other members of the toy industry, we suggest that you insert your 1981 financial data in the spaces provided.

The report, except for portions stated, has been confidentially compiled by us at the direction of the Toy Manufacturers of America. Since the information used in producing this report has not been audited by us, we express no opinion on this information.

Your participation in this project is appreciated, and we solicit your comments and suggestions to further improve this report and increase member participation.

Touche Ross & Co.

HOW TO USE THE REPORT

A comparison of your performance to the industry data can be informative and revealing. Your firm's operating experience may be different. As a result, some of your figures may vary from the averages shown. These differences are not necessarily good or bad but may suggest that further analysis and investigation be undertaken. A careful review of prior years' ratios and statistics may reveal trends indicative of certain problem areas which require management's attention. Due to the small number of participating members with sales of under \$7 million who were able to supply financial information over a five-year period, the operating trend statistics for this group should not be considered to indicate industry norm.

In order to facilitate a comparison of your Firm's performance with that of comparable industry members, each statement has a blank column headed "Your Firm." Entry of your figures into these columns provides a quick comparison of your and other firms' operating performance.

In analyzing your own performance, focus on your key ratios as they compare in each of the key areas — Sales, Profitability and Asset Management.

The following are some of the questions that you should ask:

Sales

- Is your growth comparable to your competitor?
- Has your growth been steady or erratic?
- Have you been generating sufficient sales based upon your asset and equity investments?
- Is your rate of growth greater than the rate of inflation?

Profitability

- Is your gross profit acceptable?
- Is your net income on sales satisfactory?
- How does your return on equity and total assets compare to others?
- Are your operating expenses in line with that of your competitors?

Asset Management

- Are you in a good position to meet your maturing short-term credit obligations?
- How does your collection period compare with your competitors?
- Is your inventory turnover satisfactory?
- Do you have too much debt financing?
- Are you over-invested in fixed assets?

A review and comparison of your operating statistics with those of your industry will enable you to obtain answers to many of the above questions.

NOTES

1. Prior year's information set forth on schedules of Operating Trends was compiled from the information furnished by members participating in the 1981 Report.
2. On the Selling Outlet Classification analyses, the number of 1981 reporting companies is listed in a bracket < >.
3. The compilation by Product Line reflects the product which most characterizes each company as provided on the 1981 Questionnaire.

OPERATING TRENDS

The following tables summarize the key operating percentages for the past four years as reported by participating members. The operating trends were compiled from information furnished by the current years' cooperating members some of which may not have participated in prior years' projects.

SALES INCREASES (DECREASES) – PERCENTAGE OF PRIOR YEAR SALES

	1978	1979	1980	1981
– Under \$7 Million Gross Annual Sales	33.3	113.6	19.7	193.4
– \$7 – \$35 Million Gross Annual Sales	7.8	18.3	2.7	9.8
– Over \$35 Million Gross Annual Sales	12.7	25.3	9.9	13.8
– All Companies	12.1	24.6	9.0	13.5

OPERATING TRENDS

GROSS PROFITS — PERCENTAGE OF SALES

	1978	1979	1980	1981
— Under \$7 Million Gross Annual Sales	27.3	57.5	40.5	39.0
— \$7 — \$35 Million Gross Annual Sales	31.7	30.9	30.4	33.1
— Over \$35 Million Gross Annual Sales	39.2	41.8	41.4	43.9
— All Companies	38.3	40.5	40.3	42.8

OPERATING TRENDS

OPERATING EXPENSES – PERCENTAGE OF SALES

	1978	1979	1980	1981
– Under \$7 Million Gross Annual Sales	158.0	64.9	88.2	41.9
– \$7 – \$35 Million Gross Annual Sales	21.9	22.2	24.5	23.8
– Over \$35 Million Gross Annual Sales	28.6	29.6	31.1	31.2
– All Companies	27.9	28.8	30.5	30.5

OPERATING TRENDS

INCOME (LOSS) BEFORE INCOME TAXES — PERCENTAGE OF SALES

	1978	1979	1980	1981
— Under \$7 Million Gross Annual Sales	(138.6)	(12.2)	(40.1)	(8.7)
— \$7 — \$35 Million Gross Annual Sales	8.6	6.9	3.6	6.3
— Over \$35 Million Gross Annual Sales	8.5	10.6	7.8	9.8
— All Companies	8.5	10.2	7.3	9.3

TOY MANUFACTURERS OF AMERICA, INC.
1981 FINANCIAL AND OPERATING RATIO REPORT
SUMMARY — INCOME STATEMENT
ALL PRODUCT LINES

	ALL COMPANIES		YOUR FIRM	SALES LESS THAN \$7MM		SALES \$7MM TO \$35MM		SALES OVER \$35MM	
	AVERAGE			AVERAGE	AVERAGE	AVERAGE	AVERAGE		
Returns — % to gross sales	3.0			1.1		1.6		3.2	
Discount and allowances - % to gross sales	4.7			2.3		4.1		4.8	
Net Sales	100.0	100.0	100.0	100.0		100.0		100.0	
Cost of Goods Sold	57.2			61.0		66.9		56.1	
Gross Profit	42.8			39.0		33.1		43.9	
Operating Expenses									
Administrative	9.6			24.5		8.8		9.6	
Shipping	3.7			3.2		4.3		3.6	
Selling (including Royalties)	17.2			14.2		10.7		18.0	
Total Operating Expenses	30.5			41.9		23.8		31.2	
Other (Income) or Expenses	3.0			5.8		3.0		2.9	
Income (Loss) Before Taxes	9.3			(8.7)		6.3		9.8	
Key Ratios									
Sales Performance									
Sales per dollar of tangible assets	1.6			1.8		1.8		1.6	
Sales per dollar of invested capital	3.1			(8.5)		3.3		3.0	
Sales increase (decrease) %	13.5			193.4		9.8		13.7	
Profitability Performance									
Income on sales (%)	9.3			(8.7)		6.3		9.7	
Gross Profit (%)	43.0			39.0		33.1		43.9	
Return on tangible assets (%)	16.2			(30.0)		12.0		16.8	
Return on invested capital (%)	28.0			.9		20.8		28.9	

TOY MANUFACTURERS OF AMERICA, INC.
1981 FINANCIAL AND OPERATING RATIO REPORT
SUMMARY – BALANCE SHEET
ALL PRODUCT LINES

	ALL COMPANIES	YOUR FIRM	SALES LESS THAN \$7MM	SALES \$7MM TO \$35MM	SALES OVER \$35MM
	AVERAGE		AVERAGE	AVERAGE	AVERAGE
Assets					
Cash	2.8		1.6	5.0	2.6
Receivables	31.2		30.1	33.4	31.0
Inventory	25.0		45.6	31.4	24.2
Marketable securities	1.3		13.6	0.0	1.3
Other current	1.9		3.3	1.9	1.9
Total Current	62.2		94.2	71.7	61.0
Fixed Assets (includes Capitalized Leases)	19.9		5.6	26.3	19.4
Other	13.1		.2	.5	14.4
Total Tangible Assets	95.2		100.0	98.5	94.8
Intangible Assets	4.8		0.0	1.5	5.2
Total	100%	100%	100%	100%	100%
Liabilities					
Accounts Payable	10.0		8.3	9.8	10.1
Notes Payable	2.6		1.0	5.1	2.4
Current Portion – Long-term Debt	.6		.6	1.4	.5
Taxes	1.0		(3.0)	1.6	.9
Other Current	10.6		2.7	11.8	10.5
Total Current	24.8		9.6	29.7	24.4
Long-term (includes lease obligations)	5.4		6.4	11.5	4.9
Other	10.0		46.4	1.9	10.5
Total Liabilities	40.2		62.4	43.1	39.8
Stockholders' Equity	59.8		37.6	56.9	60.2
Total	100%	100%	100%	100%	100%
Key Ratios					
A. Asset management measures					
Current ratio (Times)	2.5		9.8	2.4	2.5
Accounts receivable					
Collection period (days)	116.9		66.8	84.8	120.7
Percentage working capital	142.7		43.3	102.0	147.9
Inventory					
Turnover (times)	3.6		1.3	3.5	3.6
Percentage working capital	68.8		59.4	82.1	67.4
Long-term debt to invested capital (%)	9.9		16.9	17.7	9.1
Fixed asset replacement rate	174.2		101.3	102.5	187.3

TOY MANUFACTURERS OF AMERICA, INC.

1981 FINANCIAL AND OPERATING RATIO REPORT CELLING OUTLET CLASSIFICATION

ALL PRODUCT LINES

	ALL COMPANIES	YOUR FIRM	SALES LESS THAN \$7MM	SALES \$7MM TO \$35MM	SALES OVER \$35MM
	AVERAGE		AVERAGE	AVERAGE	AVERAGE
Sales (% gross sales)					
Selling Outlet Classifications:					
Toy/Sporting Goods Store	20.5		23.4	11.7	21.4
Department Store	5.2		4.8	7.4	5.0
Chain and mail order	27.2		47.1	26.0	27.2
Discount	23.2		19.2	28.9	22.6
Other	23.9		5.5	26.0	23.8
Total Sales	100%	100%	100%	100%	100%
Base: Reporting Companies	< 35 >		< 6 >	< 14 >	< 15 >

TOY MANUFACTURERS OF AMERICA, INC.
1981 FINANCIAL AND OPERATING RATIO REPORT
OPERATING STATISTICS
ALL PRODUCT LINES

Operating Expenses:	ALL COMPANIES	YOUR FIRM	SALES LESS THAN \$7MM	SALES \$7MM TO \$35MM	SALES OVER \$35MM
	AVERAGE		AVERAGE	AVERAGE	AVERAGE
Administrative Expenses:					
Salaries and wages	2.7		9.6	3.5	2.5
Payroll taxes and benefits	.8		1.6	.8	.8
Operating supplies	.3		1.2	.4	.3
Purchased Services	1.3		2.8	1.2	1.3
Facilities charges	.9		2.1	.5	.9
Research & development	2.5		3.0	1.6	2.7
Miscellaneous or other	1.1		4.2	.8	1.1
Total administrative expenses	9.6		24.5	8.8	9.6
Shipping Expenses:					
Salaries and wages	.8		1.4	1.0	.7
Payroll taxes and benefits	.2		.1	.3	.2
Operating supplies	.1		.2	.1	.1
Freight costs	2.1		.4	2.4	2.1
Purchased services	.1		.1	.2	.1
Facilities charges	.3		.5	.3	.3
Miscellaneous or other	.1		.5	0.0	.1
Total shipping expenses	3.7		3.2	4.3	3.6
Selling Expenses:					
Direct sales — salaries and commissions	1.7		6.5	3.4	1.7
Administrative salaries and commissions	.9		.3	.7	.9
Merchandising and designing salaries	.4		.1	.3	.4
Payroll taxes and benefits	.4		.3	.2	.4
Operating supplies	.3		.7	.3	.3
Purchased services	1.0		1.7	.5	1.0
Facilities charges	.3		.8	.4	.3
Advertising	10.9		3.4	4.1	11.6
Miscellaneous or other	1.3		.4	.8	1.4
Total selling expenses	17.2		14.2	10.7	18.0
Total operating expense	30.5		41.9	23.8	31.2
Other:					
(Other Income)	(1.4)		(2.0)	(.6)	(1.5)
Interest expense	2.4		6.1	3.5	2.2
Other deductions	2.0		1.7	.1	2.2
Total Other (income) or expense	3.0		5.8	3.0	2.9
Supplemental Information					
Data processing	1.0		.6	.9	1.1
Royalties	2.3		2.0	.9	2.5
Bad Debts	.6		1.1	.4	.6
Capital expenditures	3.7		.7	3.4	3.7
Depreciation and amortization	2.1		.7	3.3	2.0

WHO MADE THIS REPORT POSSIBLE

Thirty-five manufacturers with sales in excess of \$2.85 billion reported their confidential figures to Touche Ross & Co. To assist you in evaluating the data contained in this report, we have analyzed the participants by dollar sales and product line.

By Dollar Sales (000's Eliminated)

<u>Volume Group</u>		<u>Number of Participants</u>
From	To	
0	7 Mill	6
7	35 Mill	14
35	—Mill	15
		<u>35</u>
0	10 Mill	8
10	20 Mill	6
20	50 Mill	6
50	100 Mill	7
100	— Mill	8
		<u>35</u>

By Product Line (See Note 3)

<u>Category</u>	<u>Number of Participants</u>
Dolls and stuffed toys	7
Games	8
Power Driven Toys	3
Infant and Preschool Toys	7
Crafts	3
Riding Vehicles and Sporting Goods	3
General Toy Category	4
	<u>35</u>

EXPLANATION OF KEY RATIOS

A. ASSET MANAGEMENT MEASURES: (See Summary Balance Sheet)

CURRENT RATIO (TIMES)

Calculation: Total current assets (at end of year) divided by the total current liabilities (at year-end).

Significance: The ratio indicates the potential ability of the Company to pay its current obligations as they come due.

Accounts Receivable:

COLLECTION PERIOD (DAYS)

Calculation: Period – 360 days divided by the result obtained after dividing net sales by the average monthly accounts receivable.

Significance: Shows the average number of days required to collect the accounts receivable.

PERCENTAGE OF WORKING CAPITAL (%)

Calculation: Average monthly accounts receivable divided by the average working capital.

Significance: Indicates the percentage of the working capital invested in the accounts receivable.

Inventory:

TURNOVER (TIMES)

Calculation: The cost of goods sold divided by the average periodic inventory (average of the beginning and ending inventory for the year used if monthly inventories are not available).

Significance: Reflects the number of times the average inventory is sold (or turned over) during the year.

PERCENTAGE OF WORKING CAPITAL (%)

Calculation: Average periodic inventory divided by the average working capital.

Significance: Shows the percentage of working capital invested in inventory.

LONG-TERM DEBT TO INVESTED CAPITAL (%)

Calculation: Determine by dividing the average long-term debt by the average invested capital (stockholders' equity less intangible assets).

Significance: Indicates the relationship of owner's tangible equity to long-term indebtedness.

FIXED ASSETS REPLACEMENT RATE

Calculation: Annual capital expenditures for fixed assets divided by the annual depreciation and amortization.

Significance: Indicates the rate at which the Company is replacing its fixed assets and whether replacements are being financed from depreciation and amortization.

B. SALES PERFORMANCE: *(See Summary Income Statements)*

SALES PER DOLLAR OF TANGIBLE ASSETS

Calculation: Net sales divided by average tangible assets.

Significance: Indicates the dollar sales generated by each dollar of average tangible assets for the year.

SALES PER DOLLAR OF INVESTED CAPITAL

Calculation: The net annual sales were divided by the average invested capital (stockholders' equity less intangible assets).

Significance: The ratio reflects the number of times tangible owners' equity turns over in relation to net sales.

SALES INCREASE OR (DECREASE) (%)

Calculation: Annual increase or decrease in net sales divided by prior year's net sales.

Significance: Indicates the percentage of change in annual net sales.

C. PROFITABILITY PERFORMANCE: *(See Summary of Income Statements)*

RETURN ON TANGIBLE ASSETS (%)

Calculation: Net income before taxes divided by average tangible assets.

Significance: Measures the rate of return prior to provision for income taxes in relation to average total tangible assets employed.

RETURN ON INVESTED CAPITAL (%)

Calculation: Net income before taxes divided by average invested capital (stockholders' equity less intangible assets).

Significance: This percentage measures the income before taxes earned in relation to average invested capital.

TOY MANUFACTURERS OF AMERICA

1982 FINANCIAL AND OPERATING RATIO REPORT

Prepared By

**Mr. John R. Mackay
Dr. Albert D. Bates
Profit Planning Group
934 Pearl Street
Boulder, Colorado 80302
303-444-6212**

1.

EXECUTIVE SUMMARY

TMA members surveyed this year achieved a Return on Net Worth (RONW) of just under 9 percent. Not bad, considering the state of the economy in 1982. However, a RONW of 15-20 percent is needed in the long term. High performance member firms (upper 25%) were indeed able to achieve an 18.7 percent return.

Financial Results

Gross Margin was typically 39.5 percent of sales. After operating expenses of 31.8 percent, this produced an operating profit of 7.6 percent. Payroll was the largest operating expense, with 12-14 percent of sales. After 2.2 percent interest expense and taxes, net profit was equal to 2.4%.

Inventory accounted for approximately 30 percent of total assets. Toy Manufacturers in this survey turn over their inventory 3.5 times per year. Accounts Receivable made up 32 percent of total assets. A typical TMA member had 66 days of accounts receivable outstanding by the end of their fiscal year.

Strategic Profile

Discount department stores represent the largest retail customer base with 26 percent of manufacturer's sales. This was followed by toy stores (18%) and general merchandise chains (14%). Fifteen percent of the products were sold through wholesalers. Fifty (50) percent of sales were for extended dating terms of 90 days or more.

Most advertising dollars, 77%, were allocated for television. In addition, 73 percent of the firms surveyed provided co-op advertising, usually they reimbursed 2 percent of total dollars purchased.

High Performance Firms

As pointed out earlier, high profit members as a group achieved a RONW of 18.7 percent. Return on Assets for high performers was 10.0 percent.

The largest factor that set this elite group apart was their improved profit margin of 5.4 percent of sales. This was due mainly to commanding a gross margin of 45.0 percent, 5 percent above the norm, and reduced interest expense of 1.6 percent of sales. Another related factor that contributed to high performer's success was their ability to generate more sales per dollar invested in inventory (8.6 times). Coupled with gross margin, these firms achieved a Gross Margin Return on Inventory of 314 percent.

A total of 53 companies returned questionnaires of this year's survey. 42 of those were with detailed enough financial results to be useful. This high profit group was top 10 companies which composed the upper 25 percent based on Return on Assets.

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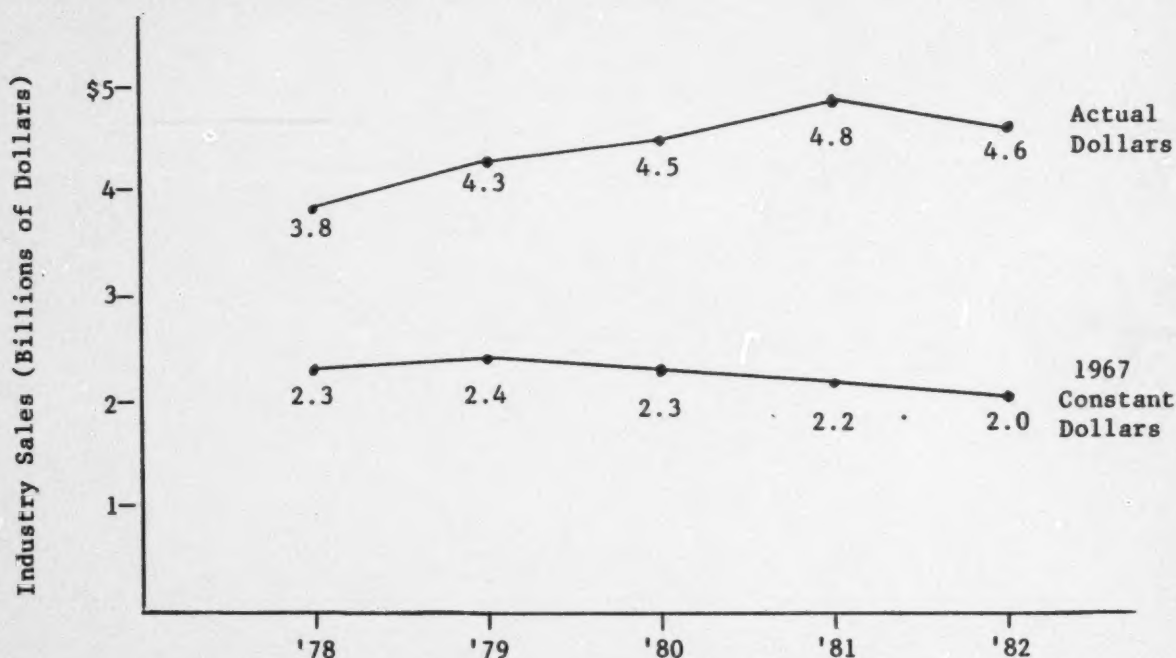
**THE PROFIT CHALLENGE:
INSURING SURVIVAL AND PROVIDING FOR SUCCESS**

By any measure you want to use, toy manufacturing is a tough business. The seasonal character of the industry produces severe problems in terms of planning production, organizing logistical flows and financing inventory and accounts receivable build-ups. On top of that, the product category represents a discretionary purchase, creating serious sales lags in recessionary periods. Finally, the desire to control costs produces substantial pressure from imported goods.

Despite these problems, many toy manufacturers have found a way to produce exciting levels of profitability. This report focuses on how the successful firms have been able to achieve high profit results, and how other firms can work to duplicate their actions.

The Sales Mandate

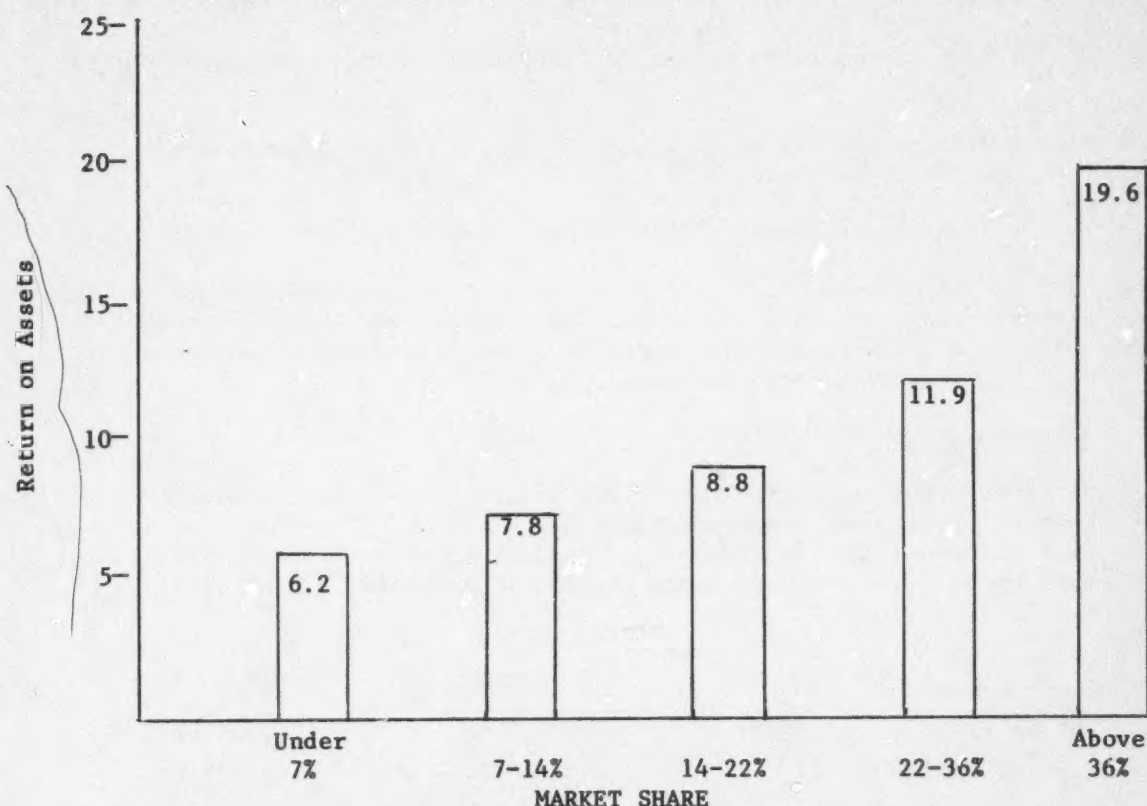
The most fundamental challenge that toy manufacturers must deal with is maintaining sales volume in an industry in which total consumer expenditures are not constantly rising. The nature of the challenge can be seen by reviewing the industry-wide figures below.



As can be seen, actual sales--as reported by TMA--actually fell in 1982 after a period of prolonged growth. However, if inflation is removed, the problem becomes much more severe. Real sales have fallen constantly since 1979.

In such an economic environment, market share management becomes a major concern. In fact, the high profit toy manufacturers in the survey actually experienced a modest sales gain in 1982, while the industry as a whole suffered a decline. The ability to hold sales levels was a key factor in their success.

The need for market share management can also be illustrated by reviewing information from the Marketing Science Institute on the relationship between market share and profitability [as measured by return on assets (after taxes)] for all manufacturing firms. As shown below, the relationship is dramatic.



The real challenge--especially for smaller firms--is how to achieve high market share. In that regard, two points seem especially relevant:

- **Market Niche Planning**--Throughout all of American industry, the most consistently successful firms are those that aim at a high market share in a sub-segment of a larger industry. The converse of trying to be all things to all people continues to be a difficult road to success.
- **Quality Emphasis**--The most difficult undertaking for most firms is to win a price battle. Successful firms more frequently than not operate in a quality market niche which provides the gross margin necessary for success.

The Determinants of Profitability

As part of this year's operating results survey, a detailed analysis was conducted to determine how the more successful firms differed from the typical firm. Six items stood out as being especially important.

- High profit firms had better sales growth.
- High profit firms had substantially higher gross margin.
- High profit firms had lower interest expense as a percent of sales.
- High profit firms had higher advertising expense as a percent of sales.
- High profit firms had higher research and development expense as a percent of sales
- High profit firms had higher inventory utilization ratios.

The importance of these factors to toy manufacturers cannot be overstated. These are the issues that TMA members need to review very carefully. To illustrate their importance, two items, sales and gross margin, will be reviewed in more detail.

Sales-Volume Sensitivities

The criticality of sales volume arises because of the high proportion of fixed costs among manufacturing concerns. The following information--based on this year's survey--indicates how even a modest real sales gain would substantially change the profit structure of the firm.

	<u>Current Conditions</u>	<u>5 Percent Sales Gain</u>
Net Sales	\$10,000,000	\$10,500,000
Cost of Goods (60.5%)	<u>6,050,000</u>	<u>6,352,500</u>
Gross Margin (39.5%)	3,950,000	4,147,500
Variable Expenses (9.0%)	900,000	945,000
Fixed Expenses	<u>2,600,000</u>	<u>2,600,000</u>
Total Expenses	<u>3,500,000</u>	<u>3,545,000</u>
Net Profit Before Taxes	\$ 450,000	\$ 602,500
Profit Margin	4.5%	5.7%

Once again, these figures reflect the criticality of market share management and the need for effective market planning.

Gross Margin Sensitivities

Given the critical impact that sales volume tends to have on performance, there is a real temptation to use price aggressively to "buy the business." The difficulty is that substantial price reductions change the economic structure of the firm in a very negative way. It is not that aggressive price competition cannot be successful, but simply that huge volume increases are necessary to make it successful.

The most important single factor distinguishing high profit firms from the typical firm was the ability to generate the gross margin necessary for success. Again, the criticality of gross margin can best be understood by reviewing an example based upon the figures from this year's survey. Assume for illustrative purposes a two percent gross margin improvement.

	<u>Current Conditions</u>	<u>2 Percent Higher Gross Margin</u>
Net Sales	\$10,000,000	\$10,000,000
Cost of Goods	<u>6,050,000</u> (60.5%)	<u>5,850,000</u> (58.5%)
Gross Margin	3,950,000 (39.5%)	4,150,000 (41.5%)
Variable Expenses (9.0%)	900,000	900,000
Fixed Expenses	<u>2,600,000</u>	<u>2,600,000</u>
Total Expenses	<u>3,500,000</u>	<u>3,500,000</u>
Net Profit Before Taxes	\$ 450,000	\$ 650,000
Profit Margin	4.5%	6.5%

In reality, the gross margin of high profit firms is not 2.0 percentage points higher than the average, but 4.5 percentage points higher. The profit implications are obvious.

Planning Performance

The toy industry is not risk free. Given the level of risk involved, firms need to produce a rate of return on investment that justifies that risk. At present, there are some interesting investment opportunities with little or no risk:

Treasury Bills	8.9%
Certificates of Deposit	9.5
Freddie Mac Mortgages	13.3

The current rate of return on net worth (before taxes) in the toy industry is 13.0 percent. Clearly, that return is not nearly as high as it should be.

We hope that this report helps with that planning process. If there are any questions, please contact the Profit Planning Group.

STRATEGIC PROFIT MODEL

One of the most valuable benefits of an annual Operating Results Study is the ability to review industry performance and establish realistic guidelines for future management actions. In addition, this report reviews the performance of the most successful firms and provides target budgetary goals based on these high profit companies. High performance firms were defined as the top 25 percent of the companies, based on return on assets.

The obvious objective for any manufacturer is to maximize return on investment. The Strategic Profit Model provides Return on Net Worth as a measure of profitability. That is, profit gained for every dollar that owners or shareholders invest, or Net Profit divided by Net Worth. Return on New Worth (RONW) and the entire Profit Model provide a common criterion to compare companies with each other and to compare TMA members as a group with other industries.

Three major components make up the Profit Model: Profit Margin, Asset Turnover, and Financial Leverage. By effectively managing each and/or all of these components, a firm may improve their Return on Net Worth.

Profit Margin (after taxes)

The first component of the profit model, profit margin, is equal to Net Profit as a percent of Net Sales. TMA members should target their operations to achieve a profit margin of 5.4% of sales based upon the performance of the most successful firms.

In 1982, a difficult economic year, TMA members typically achieved a 2.4 percent profit margin. Indeed, profit margin was the primary factor that separated the high performance company from the typical manufacturer.

Asset Turnover

Asset Turnover is defined as Net Sales divided by Total Assets. In other words, Asset Turnover is the sales volume generated for every dollar that is invested in assets. This ratio measures the productivity of assets employed in a business. A typical firm had an asset turnover of 1.6 times. High performers, on the other hand, managed to turn over their assets slightly more often, 1.9 times.

Return On Assets (after taxes)

Profit Margin times Asset Turnover yields Return on Assets. Return on Assets, therefore, is equal to Net Profit as a percent of Total Assets. This ratio measures the profitability of assets employed in a business. High profit companies achieved an ROA of 10 percent compared to a typical company's performance of 4 percent return on assets.

Financial Leverage

The final component of the Profit Model which a company can control is financial leverage. This ratio is Total Assets divided by Net Worth. Leverage measures the extent to which a company depends on outside financing. TMA members typically leveraged their equity 1.8 times. This means that the owners invested \$1.00 to produce \$1.80 in total assets. The implication is that the other \$.80 was provided by outsiders.

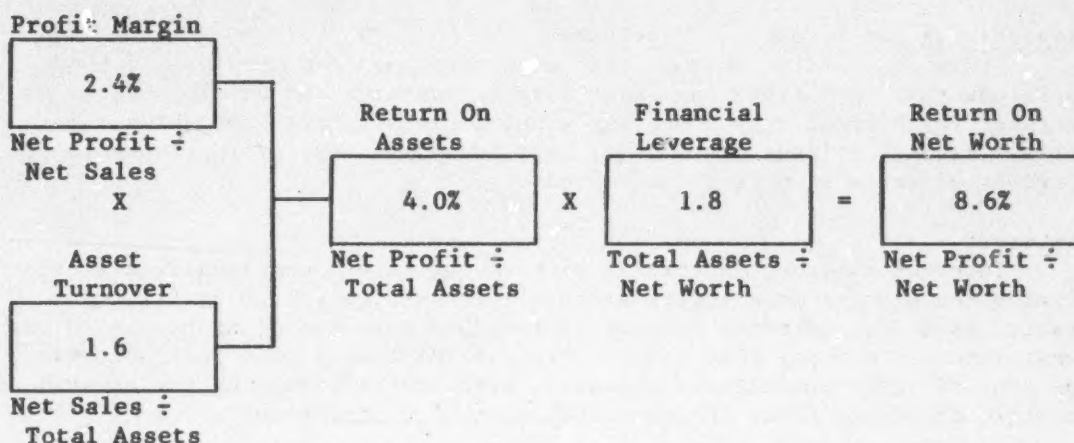
Most financial analysts agree that financial leverage of 2.0 times is well within reason. Bankers may tolerate ratios as high as 2.5 times. However, leverage of 3.0 times is a definite danger signal.

Return On Net Worth (after taxes)

Return on Net Worth is the single most important measure of financial performance. It is calculated by multiplying Return on Assets by Financial Leverage or Net Profit as a percent of Net Worth. To be successful in the long run, manufacturers should achieve a 20% Return on Net Worth.

Considering all firms, TMA members achieved an 8.6% percent Return on Net Worth. The most successful firms, however, managed to achieve an 18.7 percent return. Excellent results, considering the state of the economy in 1982.

Strategic Profit Model--A Graphic Presentation



Profit Model Ratios	All Companies	High Profit Companies	Sales Volume		
			Under \$7 Mil	\$7 Mil to \$35 Mil	Over \$35 Mil
Profit Margin					
Net Profit $\div$ Net Sales	2.4%	5.4%	.1%	2.7%	2.2%
Asset Turnover					
Net Sales $\div$ Total Assets	1.6	1.9	1.8	1.7	1.6
Return on Assets					
Net Profit $\div$ Total Assets	4.0%	10.0%	.2%	4.3%	4.0%
Financial Leverage					
Total Assets $\div$	1.8	1.8	2.0	1.9	1.9
Return on Net Worth					
Net Profit $\div$ Net Worth	8.6%	18.7%	.4%	8.2%	8.6%

INCOME STATEMENT

The primary factor that sets the winners apart from the pack in profitability was their ability to bring more dollars to the bottom line. That is, high performance companies were able to generate a 5.4% profit margin while the typical toy manufacturer achieved a 2.4% profit. How, then, were these successful companies able to earn 3 percent more?

Gross Margin

Cost of goods sold is by far the largest expense a manufacturer faces, and it is extremely difficult to improve. Yet, high profit companies managed approximately a 5 percentage point improvement over industry norms. High profit firms achieve a 45 percent gross margin compared to just under 40 percent for the typical TMA member. This factor was most responsible for high profit in bottom line performance.

Advertising and Research & Development

It is interesting to note that high performance companies did spend more advertising dollars and spent more on research and development in an attempt to at least stay among the winning group. Large companies especially devoted a large portion of their budget to advertising, spending 11 percent of sales promoting their products.

Interest

Interest expense, especially with recent rates, continually differentiates the winners from losers among all industries. High profit companies paid less interest and, of course, had more operating profit to pay what interest expense they had. A typical TMA member paid just over two percent of sales in interest expense. High profit firms, on the other hand, managed to reduce their interest charges to 1.6 percent of sales.

By improving gross margin 2.5 percent and decreasing interest expense by .5 percent, a typical toy manufacturer could improve their profit margin to 5.4 percent of sales. This in turn would bring Return on Net Worth to 16-18 percent.

Other

Other operating expense did not vary significantly. The only other operating expense to be especially aware of is payroll expense, which accounted for 12-14 percent of sales for most companies.

COMPOSITE INCOME STATEMENT

	All Companies	High Profit Companies	Sales Volume		
			Under \$7 Mil	\$7 Mil to \$35 Mil	Over \$35 Mil
Gross Sales	103.8%	103.2%	103.8%	103.3%	104.3%
Returns and Allowances	2.2	1.8	2.2	1.7	2.9
Discounts	<u>1.6</u>	<u>1.4</u>	<u>1.6</u>	<u>1.6</u>	<u>1.4</u>
Total Deductions	3.8	3.2	3.8	3.3	4.3
Net Sales	100.0	100.0	100.0	100.0	100.0
Cost of Goods Sold	<u>60.5</u>	<u>55.0</u>	<u>59.8</u>	<u>65.3</u>	<u>56.6</u>
Gross Profit	39.5	45.0	40.2	34.7	43.4
Operating Expenses					
Admin. Salaries & Wages	4.4	4.5	6.3	4.3	2.8
Sales Salaries & Commissions	4.7	4.1	6.2	4.6	2.4
All Other Payroll	2.4	2.3	3.1	3.0	3.2
Payroll Taxes & Benefits	2.4	2.3	2.3	3.1	2.1
Advertising	4.6	6.6	4.3	1.8	11.4
Research & Development	1.2	1.9	1.3	.6	2.1
Utilities & Telephone	1.1	.9	1.4	1.2	.8
Occupancy Expenses	2.0	1.4	2.9	1.8	1.1
Depreciation (trucks, fixtures, equip.)	.8	1.2	1.2	.7	.9
Bad Debt Losses	.8	.5	.9	.7	.6
All Other Operating Expenses	<u>7.5</u>	<u>6.6</u>	<u>8.5</u>	<u>5.9</u>	<u>8.6</u>
Total Operating Expenses	<u>31.9</u>	<u>32.3</u>	<u>38.4</u>	<u>27.7</u>	<u>36.0</u>
Profit From Operations	7.6	12.7	1.8	7.0	7.4
Other Income:					
Royalty Income	*	*	*	*	.2
Other Income	.2	.6	.3	.6	.4
Other Expenses:					
Interest Expense	2.2	1.6	1.7	2.1	1.7
Royalty Expense	.9	.9	.2	.8	2.5
Other Expenses	<u>.1</u>	<u>1.0</u>	<u>*</u>	<u>*</u>	<u>.2</u>
Net Profit Before Taxes	4.6	9.8	.2	4.7	3.6
Income Taxes	<u>2.2</u>	<u>4.4</u>	<u>.1</u>	<u>2.0</u>	<u>1.4</u>
Net Profit After Taxes	2.4%	5.4%	.1%	2.7%	2.2%

* = Less than .1 percent of sales

BALANCE SHEETAssetsInventory

Inventory makes up 30 percent of a typical firm's total assets.

What proved to be significant in improving return on investment was the sales-to-inventory ratio and Gross Margin Return on Inventory (GMROI). Simply put, those firms that were able to generate more sales, and subsequently more gross profit, per dollar invested in inventory were more profitable.

Accounts Receivable

Accounts receivable composes nearly 32 percent of total assets for TMA members. Based on year-end receivables, it typically took a normal customer 66 days to pay their accounts.

Liabilities and Net WorthAccounts Payable

Accounts payable account for approximately 11 percent of total assets. Looked at from a slightly different perspective, suppliers invested in approximately one-third of a typical manufacturer's inventory. In other words, the accounts payable to inventory ratio shows that suppliers generally financed 35-40 percent of inventories.

Net Worth

Net Worth or Owner Equity is the capital invested in a firm by the owner or stockholders of a company. Net Worth then is the amount of capital that depends on profit to determine return on investment. Stated differently, all capital invested in a company other than net worth has a fixed interest rate or rate of return associated with it. Therefore, in order to maximize return on investment, owners should invest as little as possible, yet still remain financially sound. In 1982, owner/stockholders provided 55 percent of the capital required to run a company.

COMPOSITE BALANCE SHEET

	All Companies	High Profit Companies	Sales Volume		
			Under \$7 Mil	\$7 Mil to \$35 Mil	Over \$35 Mil
ASSETS					
Current Assets:					
Cash & Marketable Securities	8.8%	10.3%	8.6%	10.6%	6.7%
Accounts Receivable (Net)	31.8	30.7	31.1	30.0	34.7
Inventories	29.9	24.6	39.2	31.9	21.0
All Other Current Assets	<u>6.2</u>	<u>13.0</u>	<u>6.2</u>	<u>5.0</u>	<u>5.6</u>
Total Current Assets	76.7	76.3	85.1	77.5	68.0
Fixed Assets	19.7	18.6	10.7	22.2	20.4
Other Fixed or Long Term Assets	<u>1.9</u>	<u>5.1</u>	<u>3.0</u>	<u>.3</u>	<u>11.3</u>
Total Tangible Assets	100.0	100.0	98.8	100.0	99.7
Intangible Assets	<u>*</u>	<u>*</u>	<u>1.2</u>	<u>*</u>	<u>.3</u>
TOTAL ASSETS	100.0%	100.0%	100.0%	100.0%	100.0%
LIABILITIES AND NET WORTH					
Current Liabilities:					
Accounts Payable--Trade	10.3%	11.2%	15.4%	9.4%	7.7%
Notes Payable	8.1	3.5	9.9	7.2	7.7
All Other Current Liabilities	<u>12.2</u>	<u>13.1</u>	<u>8.3</u>	<u>10.9</u>	<u>15.7</u>
Total Current Liabilities	30.6	27.8	33.6	27.5	31.1
Long Term Debt	12.3	8.7	22.2	9.2	7.2
Other Long Term Liabilities	1.8	1.3	*	7.7	6.9
Net Worth	<u>55.3</u>	<u>62.2</u>	<u>44.2</u>	<u>55.6</u>	<u>54.8</u>
TOTAL LIABILITIES & NET WORTH	100.0%	100.0%	100.0%	100.0%	100.0%

* = Less than .1 percent of total assets

FINANCIAL RATIO ANALYSIS

Liquidity Ratios

Current Ratio

The current ratio is equal to current assets divided by current liabilities. This ratio measures the extent to which short-term liabilities are covered by assets and could be converted to cash in a relatively short period. Most financial analysts suggest a current ratio of around 2.0 is desirable.

Quick Ratio

The quick ratio is calculated by adding Cash, Marketable Securities, and Accounts Receivable and dividing the sum by Current Liabilities. This measures liquidity excluding inventory, which is typically the least liquid current asset. A reasonable target is 1.0 times.

Cash to Current Liabilities

This ratio measures a firm's ability to pay off current liabilities with cash. Generally, cash should equal 25 to 30 percent of current liabilities.

Accounts Payable to Inventory

The final liquidity ratio measures the extent to which suppliers finance inventories.

Earning Power Ratios

Earning Before Interest and Taxes to Total Assets

EBIT divided by Total Assets gives a measure of return based on earning that is actually used to operate a business. That is, interest expense and taxes are not employed in the actual operation of a business as other operating expenses are.

Increases or decreases in this ratio evaluate how a firm is managing their operation. If a company's Return on Assets and/or Return on Net Worth are increasing while at the same time EBIT to Total Assets is decreasing, that company is relying more heavily on outside financing rather than improved business operations. This is not to imply that use of outside capital to improve return on investment is all bad--it's not. What you must do, however, is maintain a reasonable financial balance sheet.

Time Interest Earned

The times-interest-earned ratio is determined by dividing earnings before interest and taxes by interest charges. This ratio measures the extent to which earnings can decline without a firm being unable to meet annual interest costs. Failure especially to meet interest obligations could cause concern among creditors.

FINANCIAL RATIOS

			Sales Volume		
	All	High	Under	\$7 Mil	Over
<u>Liquidity Ratios</u>	<u>Companies</u>	<u>Profit</u>	<u>\$7 Mil</u>	<u>to \$35 Mil</u>	<u>\$35 Mil</u>
Current Ratio	2.5	2.7	2.3	2.5	2.2
Quick Ratio	1.3	1.4	1.1	1.7	1.4
Cash to Current Liabilities	28.7%	37.0%	21.6%	38.5%	21.0%
Accounts Payable to Inventory	32.7%	42.4%	39.1%	31.2%	36.5%
<u>Earning Power Ratios</u>					
Earnings Before Interest & Taxes To Total Assets	11.5%	23.2%	2.8%	15.7%	12.6%
Times Interest Earned	2.8	5.0	1.5	3.2	3.1

PRODUCTIVITY RATIOS

Accounts Receivable Management

Average Collection Period (Days)

This ratio is calculated by dividing year-end accounts receivable by net sales per day. The average collection period for a typical manufacturer was 66 days.

Inventory Management

Inventory Turnover

Cost of Goods Sold to inventory gives inventory turnover. This ratio analyzes how many times a firm turns over their entire inventory stock each year. The higher the number of turns, the higher the productivity.

Sales to Inventory

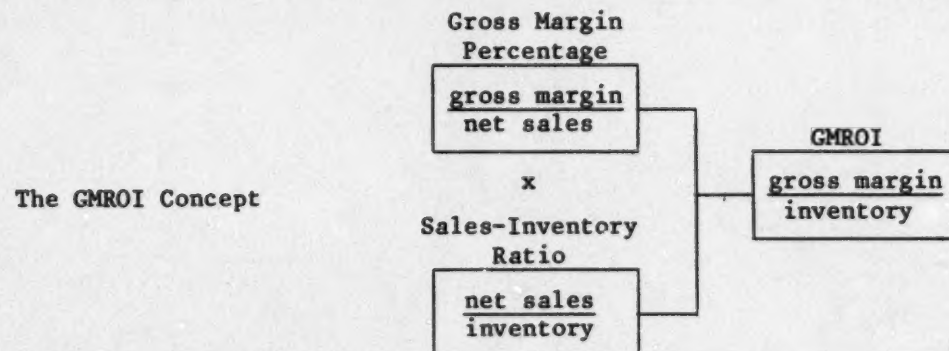
Net Sales divided by Inventory is called the sales to inventory ratio. This ratio tells how many dollars of sales the firm generates from each dollar of inventory.

Gross Margin Return on Inventory

Gross Margin divided by Inventory times 100 percent is equal to Gross Margin Return on Inventory (GMROI). GMROI gives an easy, though somewhat crude, measure of profitability per dollars invested in inventory. It is most useful when attempting to compare merchandise profitability exclusive of operating expenses.

GMROI is a very valuable concept developed for making inventory investment decisions. Although GMROI is far from a new concept, it has taken on added importance recently as interest rate pressures have necessitated exceptionally tight control over investment levels.

In simplest terms, the GMROI model demonstrates that there are two ways to improve the merchandising performance of an individual item, category or department. The first way is to improve profit, as measured by the gross margin percentage. The second is to invest dollars in inventory more productively, as measured by the sales to inventory ratio.



Employee Productivity

Sales per Salesman

Measures salesman productivity

Sales per Employee

Measures productivity of all employees in the firm.

PRODUCTIVITY RATIOS

			Sales Volume		
	All Companies	High Profit Companies	Under \$7 Mil	\$7 Mil to \$35 Mil	Over \$35 Mil
<u>Accounts Receivable Management</u>					
Average Collection Period (Days)	66	47	51	58	72
<u>Inventory Management</u>					
Inventory Turnover	3.5	5.2	2.3	3.9	3.8
Sales to Inventory	6.4	8.6	3.5	6.9	7.0
Gross Margin Return on Inventory	227.9%	314.3%	158.7%	230.9%	317.3%
<u>Employee Productivity</u>					
Sales/Employee	\$84,039	\$77,991	\$86,693	\$68,031	\$163,182
Sales/Salesman	\$1,930,390	\$1,621,570	\$1,129,270	\$2,810,500	\$1,937,430

ADVERTISING PROFILE

Advertising Expenditure by Type of Medium

Television received a majority of toy manufacturer advertising dollars. Typical manufacturers spent 77 percent of their ad budget in TV. High profit companies spent over 78 percent of their budget on television. Large companies, over \$35 million, accounted for most of the television advertising dollars. These firms spent nearly 80 percent of their advertising budget on TV.

On the other hand, magazines received 9 percent of a typical member's budget. This compares to high profit firm allocation of only 6 percent on magazine advertising.

Co-Op Advertising

Seventy-five to eighty percent of companies surveyed provided co-op advertising for their customers. The vast majority of these manufacturers based their co-op reimbursement on the dollar volume of sales a customer had purchased. Most companies would reimburse two percent of total purchases. However, some manufacturers, especially small companies, reimbursed up to five percent.

<u>Advertising Expenditure By Type of Medium</u>	<u>All Companies</u>	<u>High Profit Companies</u>	<u>Sales Volume</u>		
			<u>Under \$7 Mil</u>	<u>\$7 Mil to \$35 Mil</u>	<u>Over \$35 Mil</u>
Spot or Local Television	49%	50%	20%	25%	50%
Network Television	28	28	22	14	29
Magazines	9	6	26	42	7
Newspapers	6	5	3	2	6
Radio	*	*	0	0	*
Outdoor	*	0	4	0	0
Direct Mail	1	*	*	1	1
Other	7	11	25	16	7
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
<u>Percent of Companies Providing Co-op Advertising</u>	73%	80%	82%	81%	92%
<u>Co-op Reimbursement Policy Basis</u>					
Dollar Sales Volume	89%	88%	89%	77%	100%
Unit Sales Volume	3	12	0	8	0
Other	8	0	11	15	0
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
<u>Co-op Reimbursement Rate</u>					
1%	9%	12%	0%	27%	0%
2%	44	63	63	18	58
3%	22	0	12	36	8
4%	19	25	13	18	25
5%	6	0	12	0	8
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

CUSTOMER PROFILESales By Customer

Among the companies participating in this year's survey, one-fourth of their sales were to discount department stores. It should be noted that these figures reflect manufacturers' sales and not necessarily retail sales. This is particularly noteworthy since 15 percent of sales were to wholesalers who may also, no doubt, call on discount department stores.

Specialty toy stores purchased 18 percent of the products. The only other retail customers to amount to more than ten percent of sales were general merchandise chains which accounted for 14 percent.

Sales for Extended Datings

One-half of all sales were for extended datings of 90 days or more. This, of course, reflects the long lead time necessary to prepare for the Christmas season.

<u>Sales By Customer</u>	<u>All Companies</u>	<u>High Profit Companies</u>	<u>Sales Volume</u>		
			<u>Under \$7 Mil</u>	<u>\$7 Mil to \$35 Mil</u>	<u>Over \$35 Mil</u>
Wholesalers	15%	15%	11%	16%	15%
Discount Dept. Stores (K mart, Target, etc.)	26	26	20	35	26
Department Stores	3	3	3	6	3
General Merchandise Chains (Sears, Penneys, Montgomery Wards)	14	17	12	10	15
Toy Stores	18	17	36	16	18
Variety Stores	4	5	4	6	4
Catalog Showrooms	7	7	9	5	8
Other Retail Stores	13	10	5	6	11
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Percent of Sales for Extended Dating (90 Days or More)	50%	50%	62%	33%	60%

OPERATING TRENDS

The following tables summarize the key operating percentages for the past five years as reported by participating members. The operating trends were compiled from information furnished by the current year's cooperating members some of which may not have participated in prior years' projects.

SALES INCREASES - Percentage of Prio Year Sales

<u>Annual Sales</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Under \$7 Million	33.3	113.6	19.7	193.4	-5.5
\$7 to \$35 Million	7.8	18.8	2.7	9.8	-5.5
Over \$35 Million	12.7	25.3	9.9	13.8	-.1
All Companies	12.1	24.6	9.0	13.5	-.6

GROSS PROFITS - Percentage of Sales

<u>Annual Sales</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Under \$7 Million	27.3	57.5	40.5	39.0	40.2
\$7 to \$35 Million	31.7	30.9	30.4	33.1	34.7
Over \$35 Million	39.2	41.8	41.4	43.9	43.4
All Companies	38.3	40.5	40.3	42.8	39.5

OPERATING EXPENSES - Percentage of Sales

<u>Annual Sales</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Under \$7 Million	158.0	64.9	88.2	41.9	38.4
\$7 to \$35 Million	21.9	22.2	24.5	23.8	27.7
Over \$35 Million	28.6	29.6	31.1	31.2	36.0
All Companies	27.9	28.8	30.5	30.5	31.9

INCOME BEFORE INCOME TAXES - Percentage of Sales

<u>Annual Sales</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Under \$7 Million	-138.6	-12.2	-40.1	-8.7	.2
\$7 to \$35 Million	8.6	6.9	3.6	6.3	4.7
Over \$35 Million	8.5	10.6	7.8	9.8	3.6
All Companies	8.5	10.2	7.3	9.3	4.6